Is the m&a rebound for real?

What will 2010 bring?

Recently, we've been asked by a number of companies to comment on the state of the current m&a market for middle-market technology-enabled companies. Some firms want us to address their Board of Directors (which we are happy to do). Prospective buyers ask us what other buyers are doing and if sellers are "realistic." Prospective sellers want to know if the values are "back". Last month, we sent out a newsletter with some market statistics and our commentary. This is an update to our earlier overview.

> Globally, 3,800 deals did get done in the first half of 2009.

Clearly there has been some good news. Through the third quarter of 2009, there has been a spate of m&a deal announcements, including a few of our own. Stock markets have been rising in the US, UK, Germany, China, Japan and elsewhere, and the Chairman of the Federal Reserve has declared the end of the US recession. Even the debt markets have been ameliorating — with three month and six-month LIBOR rates back into reasonable territory. But m&a debt is still hard to come by (and expensive) for the middle-market technology-enabled firms that we work with.

According to Thomson Reuters, for the first three quarters of this year, overall m&a volume was anemic, down 38% in Q3 2009 alone, versus a not-very-robust Q3 2008, making Q3 2009 the lowest quarter since 2004. Financial sponsor m&a deal volume was down 67%, compared to the first three quarters of last year. Thomson Reuters also says that VC fund raising hit a six-year low in the third quarter, down 81% from a year ago.

Overall IPO activity is still relatively weak compared to peak levels, even though it was up 34% versus the same period in 2008. IPO activity in Asia accounted for more than 80% of this year's volume. Only five venture-backed companies managed to get out IPOs so far this year – all in Q2. That's on pace to match 2008. But, it is a far cry from 2007, when about 76 VC-backed companies had IPOs. From our vantage point, however, the environment seems to be improving. A few recent IPOs have been impressive – note for example: Bridgepoint Education (BPI). Others such as Verisk, Rosetta Stone, and Open Table are notable for their valuations, even if they now trade

> Nearly $1trillion in dry powder is available to private equity and venture capital firms.

Quarterly Digital Information Economy Mergers & Acquisitions

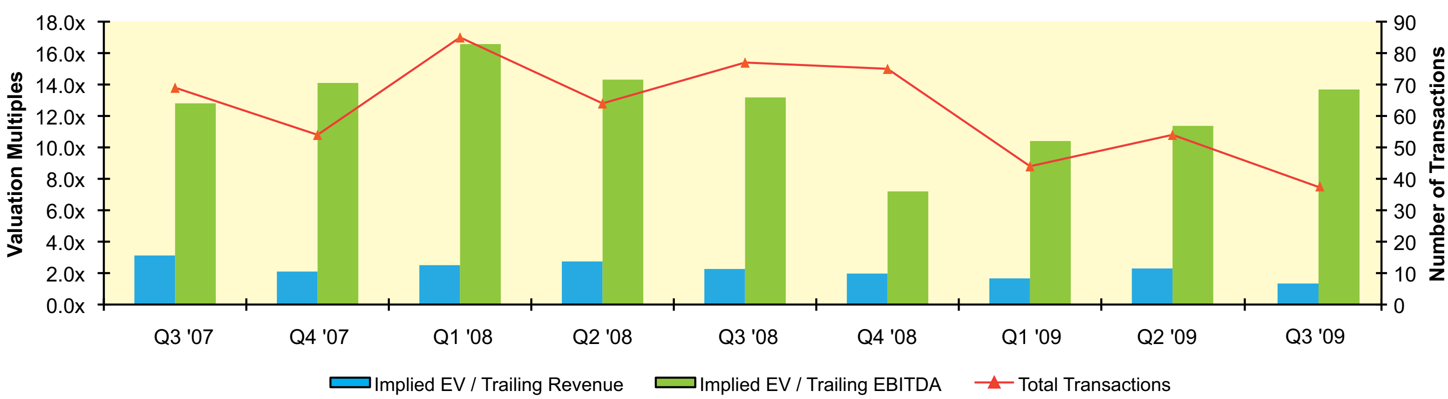


Figure 1 - Transaction volume through Q3 2009 of 136 transactions is off 40% vs. the same period in 2008. EBITDA multiples have rebounded to 13.3x in Q32009 compared to 11.4x in Q2 2009 and 10.4x in Q1 2009, but still well below 16.6x in Q1 2008. Revenue multiples dropped to 1.1x in Q3 2009 vs. 2.3x in Q2 2009 and well below the previous low of 1.7x in Q1 2009.

Source: Marlin & Associates, Capital IQ

lower than initially priced. And, the pipeline seems to be getting stronger. Since July 1st, there have been 21 IPO fillings, with 10 of them in October alone. And, there are now 47 PE-backed companies in IPO registration, according to PitchBook.

Clearly, we're in an overall economic environment that is significantly better than the one that we were experiencing at the beginning of 2009. And that is leading to an improving environment for tech m&a.

As we know, merger and acquisition activity is a trailing indicator of economic performance on both ends of the cycle. Deal

> The third quarter was the most active quarter that we have seen

activity slows well after recessions begin and it returns after economic activity recovers. Part of the reason for this lag is that, for most transactions, buying a company shifts the risk of future performance from the seller to the buyer. If buyers are uncertain about how to assess that future, or if their own challenges make them less willing to take risks, then those buyers tend to retreat (or seek lower purchase prices) until the future becomes clearer. Similarly, sellers, who may perceive the uncertainty as 'temporary', also may prefer to wait until the future is clearer and values higher. Whatever the reason, typically, the volume of deals as well as deal valuations decline after a recession has started and recover in line with, but after, economic recovery. The lag effect probably is due to a failure to recognize, or accept, that a recession actually has begun and later a similar inability to recognize that the recovery has begun.

In our part of the middle-market m&a world, we do see a gradual strengthening of demand by strategic and financial buyers. In fact, we're starting to see some strong prices again for unique, strong, growing middle-market tech companies. But weaker companies are still seeing very weak interest and weak valuations.

Financial sponsor deal volume, which had been moribund in spite of nearly $1 trillion in dry powder, recently woke up a bit. The third quarter was the most active quarter for these financial firms we've seen in a year. Note the recent deal in which a consortium of private equity firms is buying Skype for $2 billion.

VC and PE firms are not the only ones with a trillion dollars to spend. And, some of the strategic firms that have the money to spend are starting to chase deals. This year has seen the announcement of several mega-deals by strategic acquirers, including Oracle's acquisition of Sun Microsystems for $5.6 billion, Fidelity National Information Services's acquisition of Metavante for $4.4 billion and EMC's acquisition of Data Domain for $2.1 billion. More recently we've seen deals such as Intuit's effort to purchase of Mint for $170 million (not yet a done deal), and Adobe's acquisition of Omniture for $1.8 billion. Cisco opened the fourth quarter on October 1, saying that it will spend $3 billion in cash for Tandberg, the Norwegian maker of video and network infrastructure technology. These and other transactions (including some of our own recent deals – such as the sale of Vhayu to Thomson Reuters, the sale of S&P's Vista Research to Guidepoint Global, and the sale of Tenfore to Morningstar) support the notion that some buyers are regaining their courage.

> EBITDA multiples for tech mergers and acquisitions have rebounded to 13.3x

There are other reasons for optimism. A recent survey by the 451 group said that 61% of those surveyed expect an increase in m&a activity, compared with the 44% who felt that way in December. Only 10% predicted that it would decrease, compared to 24% in December. And there are other green shoots as well.

In the narrower Digital Information Economy that we serve, we tracked 136 transactions so far this year. While this is a substantial decrease from the same period last year, quarterly transaction volume has remained consistent and we're seeing more activity in Q4.

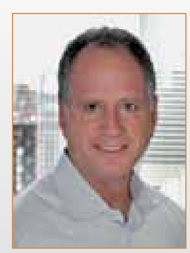
> There are now 47 PE-backed firms in IPO registration.

We're also beginning to see more aggressive bidding for deals — and we don't just mean for the big deals such as Sun Microsystems and Data Domain. We're starting to see bidding for smaller deals as well. In the first quarter of 2009, the median value of tech mergers & acquisitions was 10.4 times (see chart) trailing-twelve-months EBITDA. In Q2 of 2009, it came up to 11.4 times trailing-twelve-months EBITDA. In Q3 of 2009, it rose even further to 13.3 times trailing-twelve-months EBITDA. While average revenue multiples in Q3 fell to 1.1x trailing-twelve-month revenue, averages can be misleading. For middle-market technology-enabled firms that have managed to sustain strong top-line growth through the economic downturn the purchase multiples are significantly stronger.

M&A is working on several transactions that we expect to announce over the next few months. We expect continued increases in overall transaction activity through 2010.

The return of a bull market for stocks usually presages a return to growth in the economy, which leads to a strong m&a market. Once in full swing, the strong m&a market usually lasts a while: 1995-2001 (7 years) and 2004-2007 (4 years). Hopefully, this next one will last at least that long.

We are always available to answer your questions.



Ken Marlin
Managing Partner
Marlin & Associates

M&A
MARLIN & ASSOCIATES

Transaction Advisory for the Digital Information Economy
600 Lexington Avenue, 36th Floor ◆ New York, NY 10022 ◆ 212.257.6300
7720 Wisconsin Avenue, Suite 213 ◆ Bethesda, MD 20814 ◆ 301.469.0441
150 York Street, Suite 1900 ◆ Toronto, Ontario M5H 3S5 ◆ 416.619.4928 ◆ **www.marlinllc.com**